

What Should a Rate Study Cost?

Executive Summary: Fees paid for rate studies are frequently too high primarily because of how those services are solicited. Fees can be reduced by simplifying the service acquisition process. That part of this article that relates the author's experience is written in the first person.

I opened the mail – another request for qualifications for a water and sewer rate study. This one was from a city, population approximately 10,000, located within a three-hour drive of my office. The document was fifteen pages long – bad sign, they're looking for way more than they need.

The deal breaker – it specified several kinds of liability insurance that a small rate setting specialty firm like mine cannot get for a reasonable premium. I tossed the paper into my recycle box.

This article is about cost containment. However, fees should be no higher than number three on your good rate analyst attribute list. First should be the capability of the analyst to solve your rate setting problems. Anyone can double your rates. But it takes a good rate analyst to double your rate revenues with a high level of confidence while creating a rate structure that is demonstrably fair to your ratepayers. Second on the list should be how well the analyst fits you, professionally and personally. Fees should come in third. This article will help you get a good rate analyst who fits you well and won't cost you an arm and a leg.

This article will show you what drives fees upwards. That will help you figure out what drivers you can eliminate and still get the services you need.

Keep in mind:

- Every utility and every rate study is different from every other;
- Fees should be commensurate with services rendered;
- Services rendered should be appropriate for the situation encountered.

Buying rate study services can be likened to hiring a tax accountant. Your top priority should be getting an accountant who will get you every tax break worth taking. But if you have to pay an excessive percentage of your tax savings to the accountant you would be better off doing your own taxes.

In the rate setting arena it makes sense to do your own rate setting during most years. You should only call in the specialist when big or complex things are going on or it has been several years since your last rate study.

Back to the request for qualifications story; it didn't actually end in the recycle box, yet. A few days later an engineering firm called and asked me to partner with them

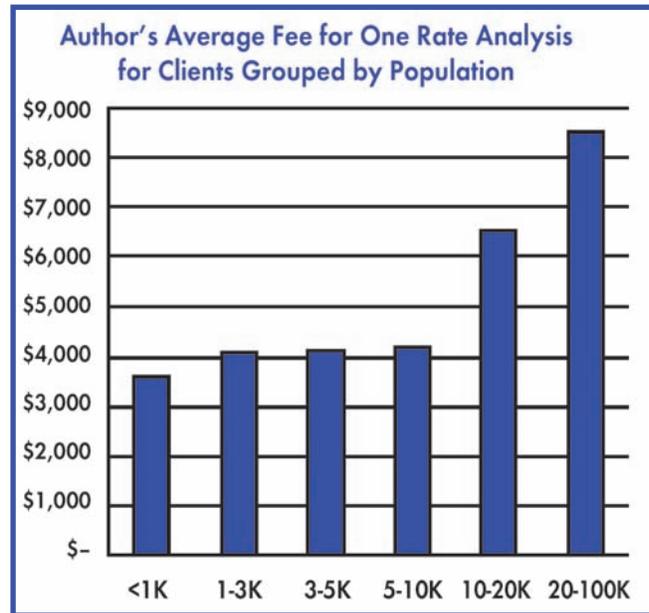


Chart notes: When compared to services as solicited by a typical request for qualifications, the fees above are usually in the middle of the bottom third of the competition so they are a reasonable estimate of the fee "floor" you may expect. Fees stay flat until the population hits 10,000 or so. Generally smaller systems have simpler rate needs largely because they have a simpler customer base – mostly residential and general commercial. However, a proper rate analysis can only get so simple. Thus, each analyst's fees can only go so low. As system size goes up, complexity goes up, especially when industrial, wholesale and other types of customers are present. The more complex the situation is, the more expensive it is to develop rates.

on that same rate study. I agreed. We worked up a proposal – it took a week. We got selected as one of the top three responders. We attended an interview. We just knew we were the best team for the project. We lost to another engineering firm. Here’s the interesting part.

If this city had solicited simply, allowed me to specify what needed to be done and did not require the extraneous insurance, I would have done this study for around \$8,000 including one trip there to present my results and recommendations to their council.

Partnering with the engineering firm to respond as specified; adding their overhead, insurance and response costs; and then adding fees to cover my response costs pushed our proposed fee to \$25,000.

The winning firm estimated their total costs at around \$70,000. However, they were willing to cap their charges at \$35,000.

Perhaps this city will actually get \$70,000 worth of rate analysis but \$8,000 would have bought what the city really needs.

An inconvenient truth, for some engineers: Rate analysis does not require a professional engineer’s seal. While all engineers are smart, few specialize in rate analysis. Rate analysts, however, specialize in rate analysis. Even so, most rate studies are done by engineers and some are good at it.

Sour grapes for losing the project? Sure, but I can’t say the winning firm “ripped the city off” with their fees. Consider it from the proposer’s point of view.

The winning firm incurred costs (marketing and acquisition) just to get this project. Their costs included staff time, response production, travel (one member of their team flew in from Florida), etc. These costs may have totaled \$5,000. If this firm wins one out of five such responses (a strong winning rate), the firm needs to make \$25,000 (\$5,000 times five tries) on this project to pay the acquisition costs. Add \$8,000 for rate study work and \$2,000 for additional profit and the total is \$35,000. (This breakdown ignores that other \$35,000.) Thus, the fee is made up of acquisition costs; the lion’s share of the fee; rate study work and profit. The level of the fee is a direct result of how the city went about soliciting these services. The city got what it (perhaps unknowingly) asked for – a very expensive rate analysis.

If you do not want to pay for high acquisition costs you need to solicit in a way that will allow proposers to keep those costs low. Following is a checklist of things to do. Some will sound like heresy but the explanations that follow the list should clear that up.

- ✓ Ditch the RFPQ (request for qualifications and proposals). Instead, decide what outcome you want to achieve. That should boil down to a simple statement like, “We want our rates to be adequate to fund our utility properly for the long term while being fairly structured for our ratepayers.”

WATER WORKS BRASS AND PIPELINE PRODUCTS



THE FORD METER BOX COMPANY, INC.

P.O. Box 443, Wabash, Indiana 46992-0443

260-563-3171 • FAX: 800-826-3487

<http://www.fordmeterbox.com>



- ✓ Gather together some basic information about the system to be analyzed. That includes the income and expense statement and balance sheet for the last completed fiscal year, capital improvement and equipment replacement projects in the works and plans for the future, the current rate chart and rate adjustment history, balance trends for the last few years and expected events that will impact the financial health of the utility. You will need this for discussions with rate analysts you solicit.
- ✓ You may require responders to carry auto, health and general accident insurance coverage, if you care to bother with it, but do not require liability coverage, often called “errors and omissions” insurance.
- ✓ When you have the rate setting goals in mind and system information at hand, canvass prospects by phone. Solicit responses only from those you determine to be rate analysts.
- ✓ Before hiring an analyst require an excellent guarantee and check their references thoroughly.

Ditch the RFPQ? Yes! You should not assemble pages and pages of requirements and specifications (expensive and time consuming on your part), mail them in a RFPQ to everyone you can find an address for, receive boxes full of response materials and have a committee wade through them for weeks trying to decide which firm would be the best to serve you. The more you specify about rate study techniques the more it will cost because you will always ask for things that are not necessary. A written rate study RFPQ, if you use one at all, should be about two pages long. Much

Can't ditch the RFPQ? Then shorten and improve it. Visit carlbrownconsulting.com/ and sign into the “ToolShed” to download the free “Model RFQ.” This is a two-page fill-in-the-blanks template in Microsoft Word format.

more than that and you are unnecessarily running up your costs. Keep it simple. If you must have a RFPQ, just use it as your “script” for talking with prospects.

If you don't mail out a long written RFPQ, or even a short one, how then can you tell rate analysts what you want them to do? That's just it. You don't need to tell them what to do. In their responses they will tell you how they intend to conduct your analysis. Let them use all the rope they want to either climb to the top of the mountain or hang themselves. Don't tell them ahead of time how to do the former and avoid the latter.

The trick to getting a great rate study at reasonable cost is finding at least one rate analyst to solicit. When you talk to a prospect you should first ask, “How do you generate income?” That will separate the analysts from the pretenders. If they are not a rate analyst there is no need to waste more of your or their time. Continue your conversation with prospective analysts by telling them your rate setting goals, project timeframe and such. Talk it over with each analyst, then receive their responses by e-mail. Phone and e-mail contact are how most facets of the rate study will be handled anyway so use them from the start.

NATGUN

Drink up, Kansas.



6.0 MG Natgun water storage tank for the City of Olathe, KS.
Engineering by Burns & McDonnell Engineering Co.

No matter where you live, our job is to make sure your community always has reliable, maintenance-free water storage. It's a job Natgun takes seriously.

You keep drinking water, Kansas, and we'll keep building water storage tanks.

913-681-6006
www.natgun.com

What is a “rate analyst?” There is an easy test. Ask the prospect what percentage of their revenue comes from doing rate studies. If it is more than fifty percent, they are a rate analyst. More is better. At ninety percent they can’t claim to be anything but a rate analyst. For rate studies, invite proposals only from rate analysts. Tell the others, “Thanks, but no thanks.” You wouldn’t ask a lawyer to design a water tower, would you?

You can call prospects, solicit three or four rate analysts from among them, review their responses and call references using about a day’s worth of time. This method is quick, easy and cheap.

Truth be told, saving on acquisition costs is critical for small systems but not that important to large ones. A large system is likely to end up raising rates enough to generate, say, \$1,000,000 more each year. If the analysis costs \$20,000 the payback period will be 7.3 days. That means the system will raise its rates and use 7.3 days worth of its extra rate revenues to pay the specialist. If the specialist charged \$40,000 the payback period would still only be 14.6 days.

If, however, a small system ends up raising rates enough to generate \$35,000 more per year and the analysis costs \$3,500, the payback period will be 36.5 days. If the analysis costs \$7,000, the payback period will stretch out to seventy-three days. Thus, \$3,500 in extra fees for a small system is worth five times more to that system than \$20,000 in extra fees to the large one. Fees are still only number three on the small system’s list of analyst attributes, but they are a very strong number three.

Almost never should you hire a rate analyst on an hourly basis. Pay for results, not hours.

Finally, rate setting carries risk. You need protection against the risk of hiring a firm that may look good, but cannot deliver the goods. You should not do that with layers of expensive insurance coverage. Collecting damages from

an insurance policy is a pain, it can be costly and it is not a sure thing. Besides that, the consultant is not paying those insurance premiums, you are. They only serve as the collection agency.

Instead of superfluous liability coverage you should require a guarantee from your responders that reads something like this, “You will be satisfied or you pay us nothing.” You should also require extensive

Solicit properly and the fee will be right.

references and check references thoroughly. No one is in a better position than a past client to tell you if a rate analyst is good. Good references and a guarantee that makes your satisfaction the responsibility of the analyst are your best assurances of good results at reasonable cost.

Now that you know how to eliminate extraneous fee drivers, what should a rate study cost your water or sewer system? The chart at the beginning of this article depicts the author’s typical fees for analysis of one utility without the extraneous fee drivers. In the chart find the population range served by your system. To that fee add between \$400 and \$1,000 to pay the analyst to appear before your board or council to present their results and recommendations if they can drive there in a reasonable time. If they have to get on an airplane, tack on \$1,500 instead. Small systems frequently require no on-site visits. Seldom do they need more than one. Larger systems sometimes require two or even three visits.

Rate study shelf-life: A reasonably comprehensive rate study should project incomes, expenses and other criteria between five and ten years into the future, as well as the rates needed to fund that future. But be reasonable – five years is about as long as you should try to go between rate analyses.



Ground Water Associates, Inc.
EXPERTISE IN WATER & WELLS

316-262-3322
FAX 316-201-1998

ROBERT L. VINCENT, C.P.G., P.Hg.
GROUND WATER GEOLOGIST

1999 N. AMIDON ST., STE. 218
WICHITA, KANSAS 67203
P.O. Box 3834
WICHITA, KANSAS 67201

SHARED OWNERSHIP • COLLABORATION • INTENSITY • DISCIPLINE • SOLUTIONS



WILSON & COMPANY
ENGINEERS & ARCHITECTS

Water Treatment & Distribution
Wastewater Treatment & Collection
Stormwater Drainage

800-255-7912 | www.wilsonco.com

When should you have the analyst present to the council or board in person? If the analyst can drive there this service is almost always worthwhile. If there will be controversy about the rate adjustments, usually because they are going to be large, an on-site visit by the analyst is money well invested. It is better that the analyst take the arrows than you.

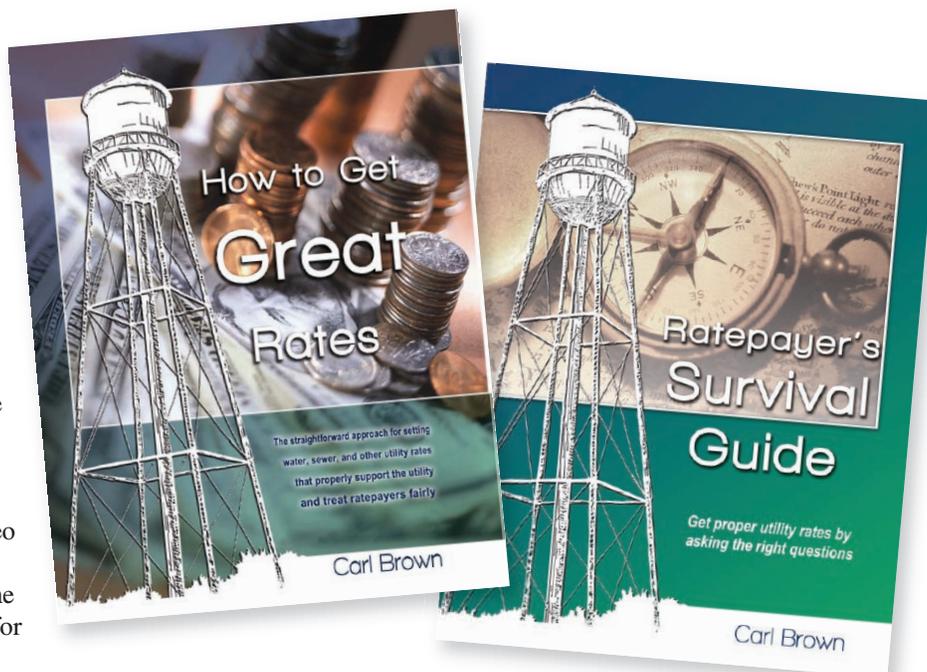
A cheap or even free alternative to the on-site visit is to have the analyst participate remotely by speaker phone. (Even in very small towns and districts we may someday do this by on-line video conference or even video phone conference.) The upside to speaker phone participation is the analyst can do rates for any system anywhere without once leaving their office. The downside, for those of us who love to go face to face with naysayers as we “educate” them, is that the speaker phone is not nearly so satisfying or “educational.”

If you want the analyst to examine a second utility; for example, analyze water and sewer rates; you should boost the dollar figure in the fee chart by seventy-five percent before adding the travel costs. In other words, the second analysis should be about twenty-five percent cheaper than the first.

Finally, whatever dollar amount you got when you did the simple math above, subtract twenty percent and add forty percent to get the range of fees that may be reasonable for your situation. Why subtract a little and add a lot? The chart is based on the author’s fees, not the market. Therefore, it is likely that your analyst’s fees will be higher rather than lower, but they will still be reasonable if they are within this range.

To demonstrate the math above, consider the systems in the one to three thousand (1-3K) population group. The average system in this group paid \$4,105 for its rate analysis. It also got a \$400 on-site visit which brought the total fee to \$4,505. Therefore, a fee range of \$3,604 on the low side (twenty percent less) to \$6,307 on the high side (forty percent more) would be reasonable for a system of this size located close to the analyst. Spread over the five years that this analysis should carry such a system’s rates, this fee range is roughly equivalent to paying \$721 to \$1,261 per year.

From another perspective, a fee of \$4,505 would cost each person in such a system 3.8¢ per month for five years to get



“How to Get Great Rates” (low cost), has an entire chapter on consultant selection. The “Ratepayer’s Survival Guide” and related resources, all free downloads, are available at <http://gettinggreatrates.com/>.

and keep rates that are adequate for the system and fairly structured for the ratepayers. That’s a cheap cheeseburger once every five years.

You now know how to estimate the range of fees you can expect to pay for a comprehensive rate analysis if you will eliminate the extraneous fee drivers before soliciting rate analysts. If you will make these simple changes you might reduce the fees you have to pay by fifty percent or more compared to traditional solicitation methods. More importantly, your rate setting results will almost certainly be better. The key to getting these results is not “holding out” for the right fee offer. The key is soliciting properly so prospective analysts can deliver what you need at the right fee.

You can get the right rate study at the right fee that will give you rates that are right for your system and right for your ratepayers, if you will just do it...right.

Carl Brown is President of Carl Brown Consulting, LLC, specializing in water, sewer and storm water system rate analysis, asset management and training nationwide; and GettingGreatRates.com, home of many rate setting tools. Contact: (573) 619-3411; E-mail carl@carlbrownconsulting.com or at <http://carlbrownconsulting.com/>.

